

The 2007-08 Federal and State Budgets and the economic outlook for 2007-08

Presentation to a luncheon for the
Launceston Chamber of Commerce

Saul Eslake
Chief Economist
ANZ

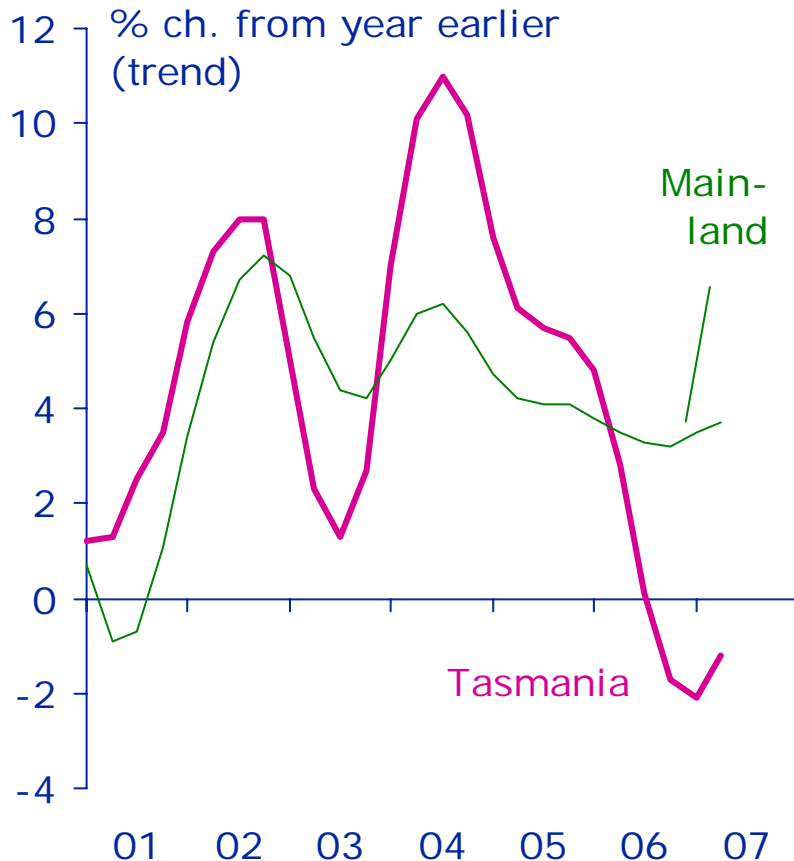
Grand Chancellor Hotel
Launceston
13th June 2007

www.anz.com/go/economics

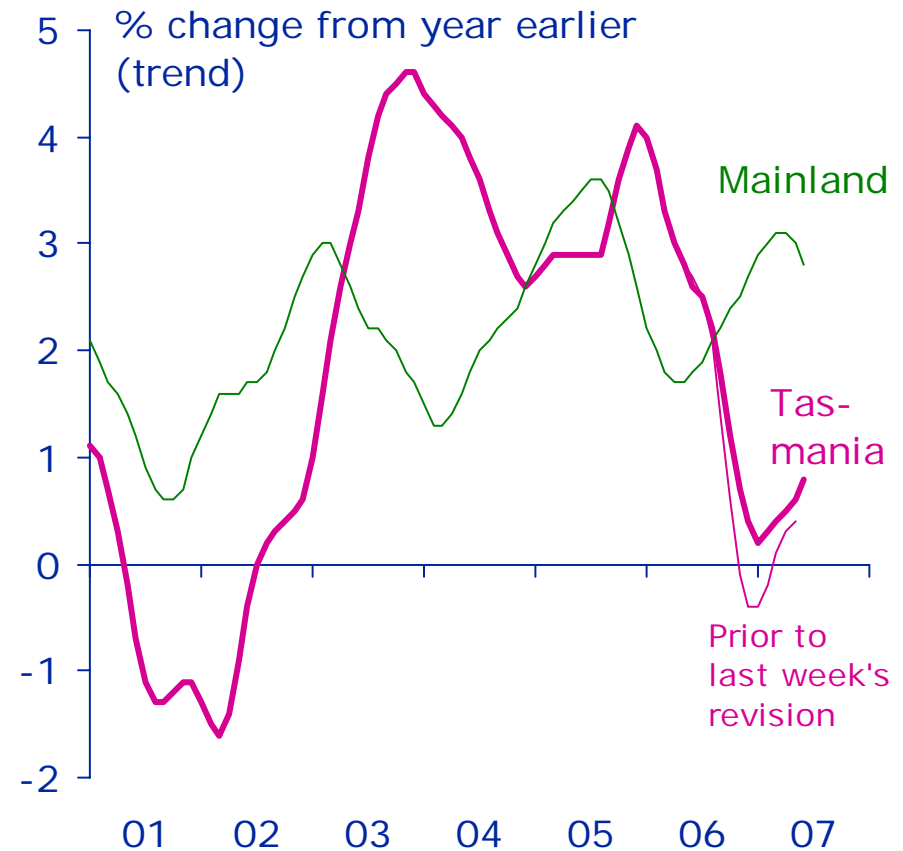
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Growth in the Tasmanian economy slowed quite markedly in 2006 but is now improving again

State final demand



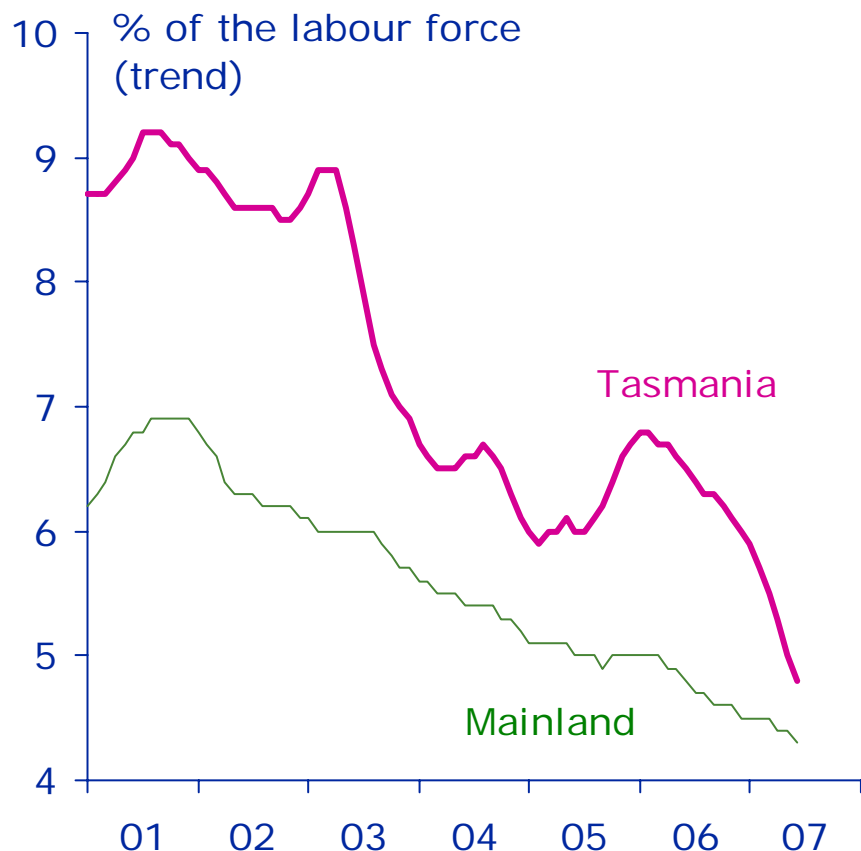
Employment



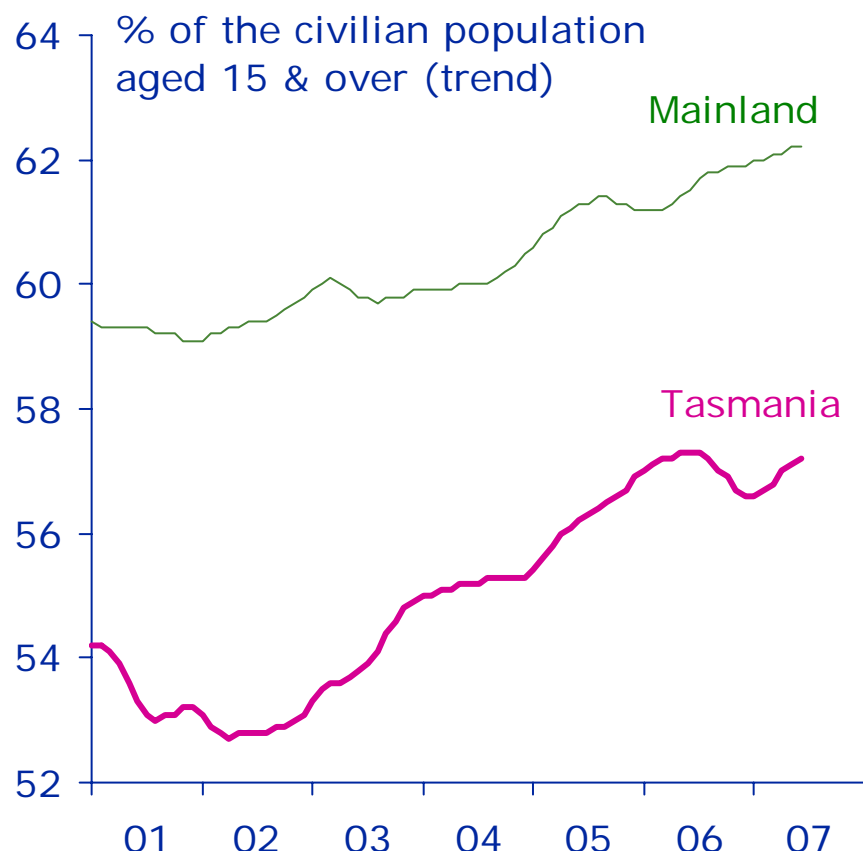
Sources: ABS, Australian National Accounts: State Details (5206.0); Labour Force (6202.0); Economics@ANZ.

Tasmania's unemployment rate is at a record low although participation remains below average

Unemployment rate



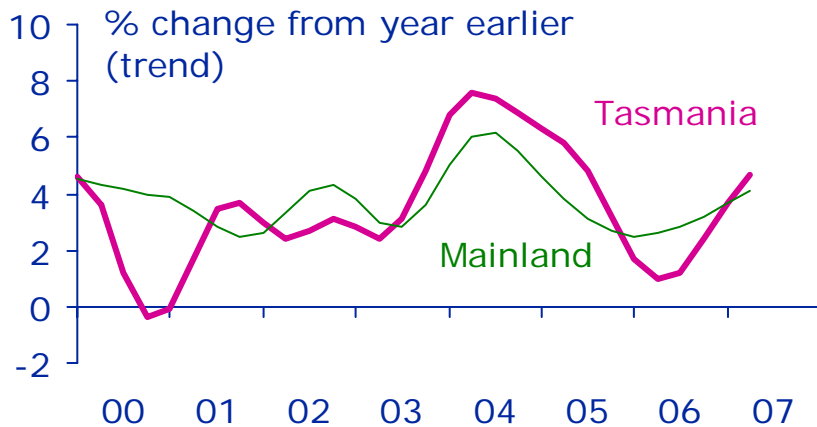
Employment-population ratio



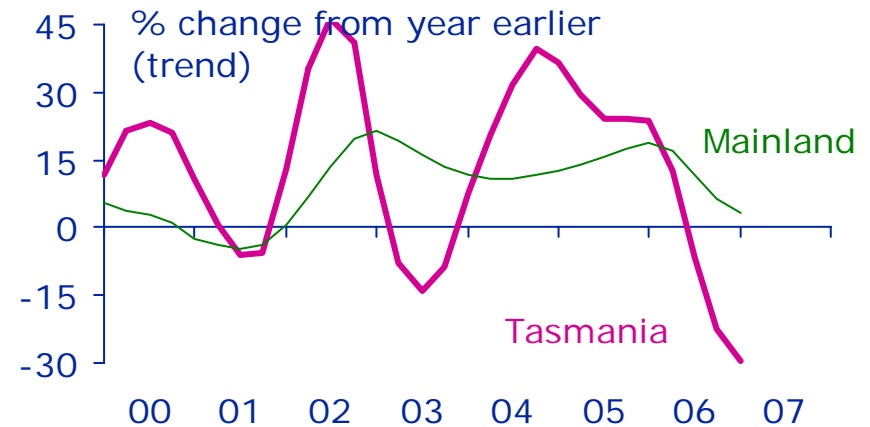
Sources: ABS, Economics@ANZ.

Most components of Tasmanian economic growth (exc. business investment) are now picking up

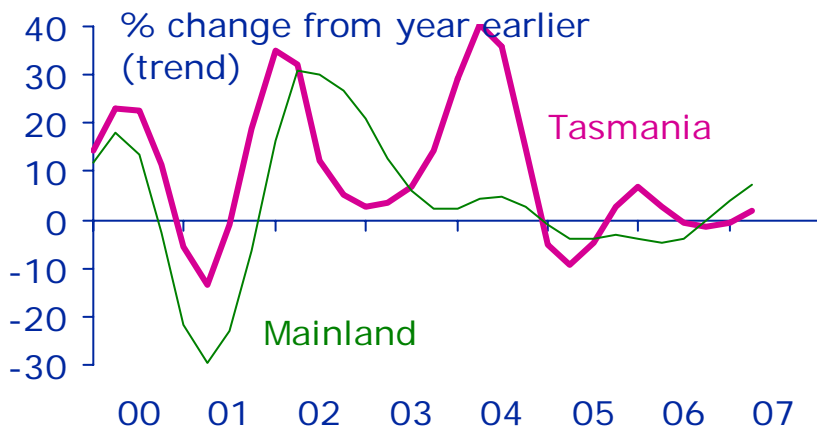
Household consumption



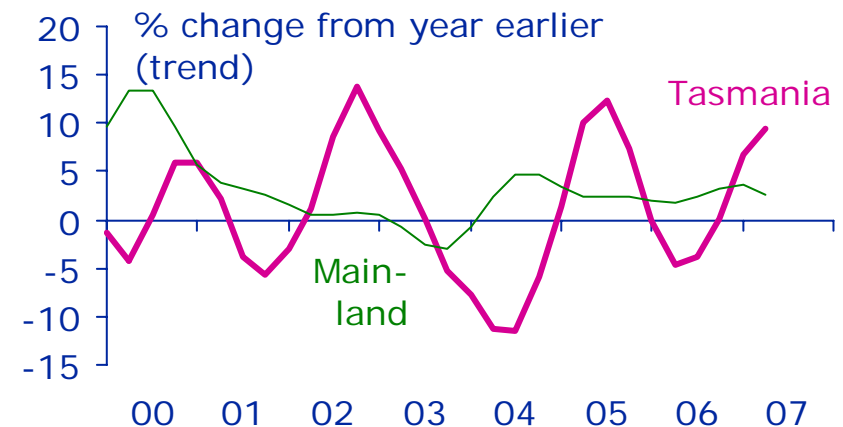
Business fixed investment



Residential investment



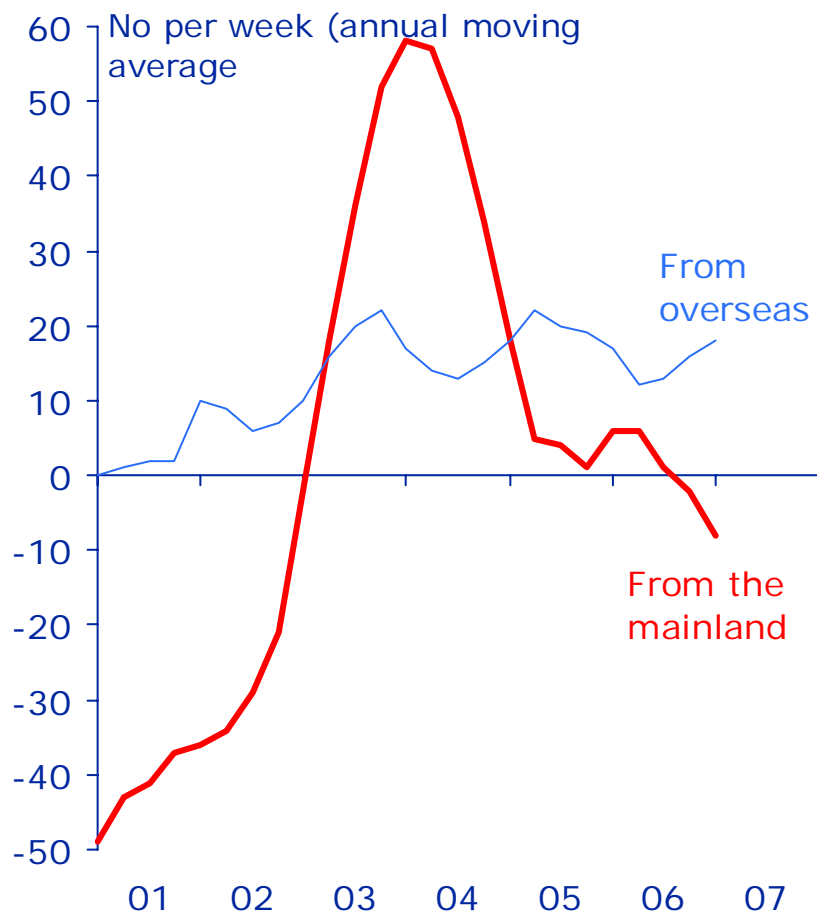
Overseas goods exports



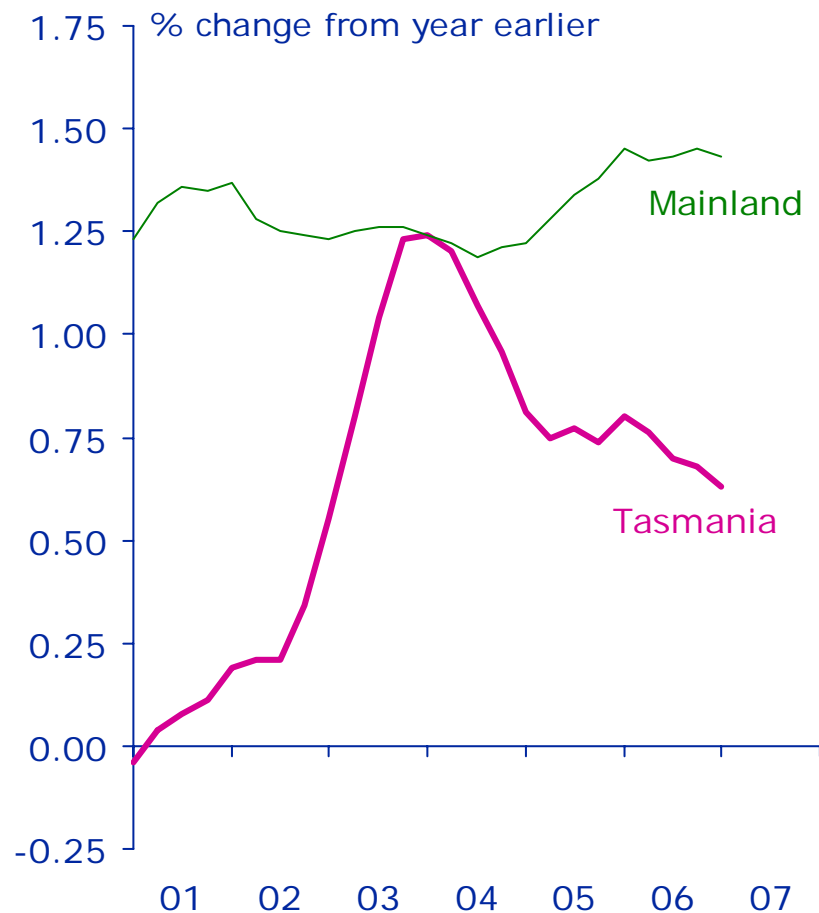
Note: March quarter data on business investment not available.
Sources: ABS; Economics@ANZ.

However the earlier surge in interstate migration to Tasmania went into reverse last year

Migration to Tasmania



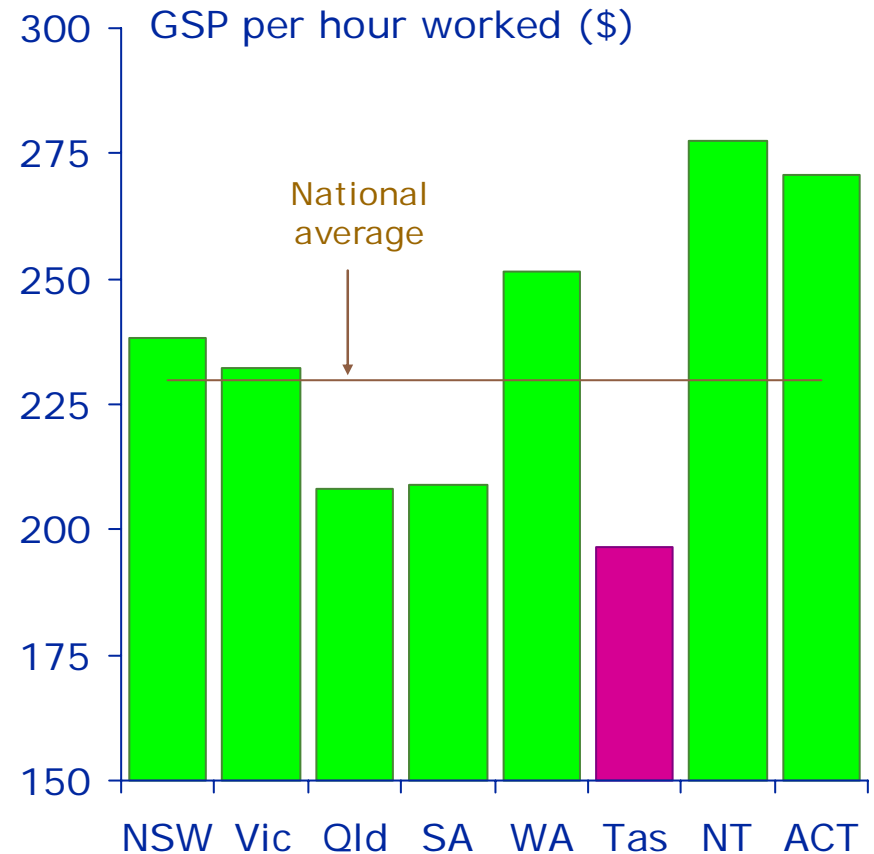
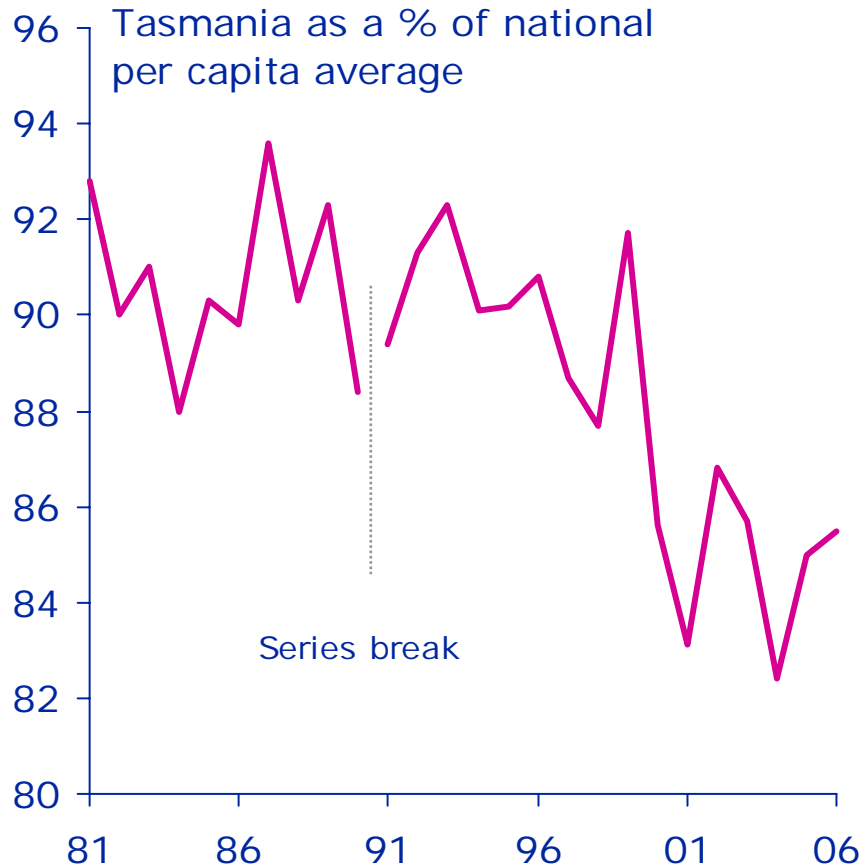
Population growth



Sources: ABS Demographic Statistics (3101.0).

Tasmanian productivity is still more than 14% below the national average

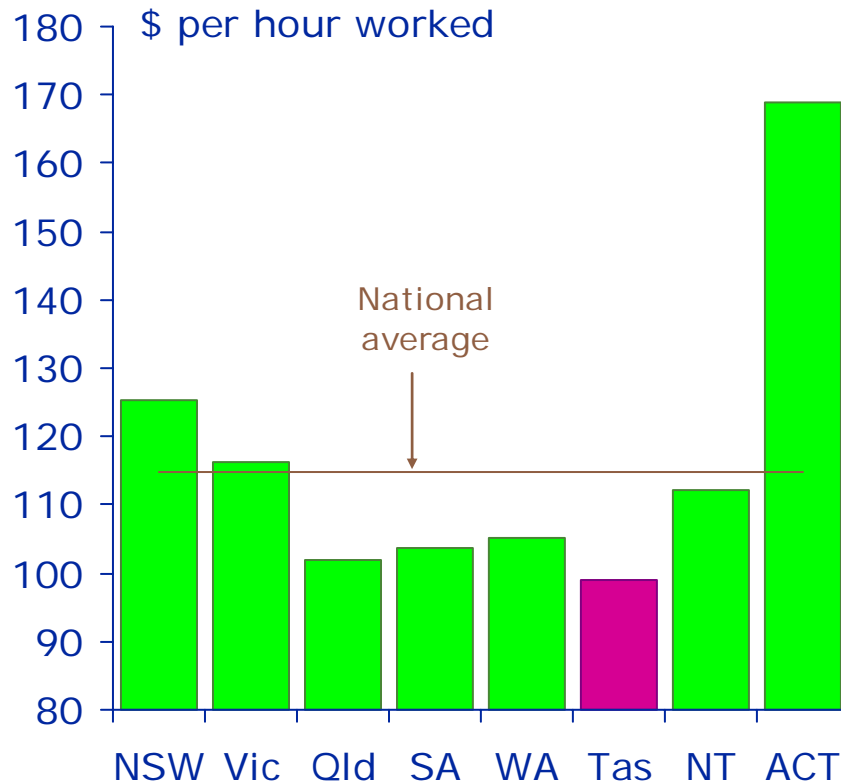
Tasmanian productivity relative to national average



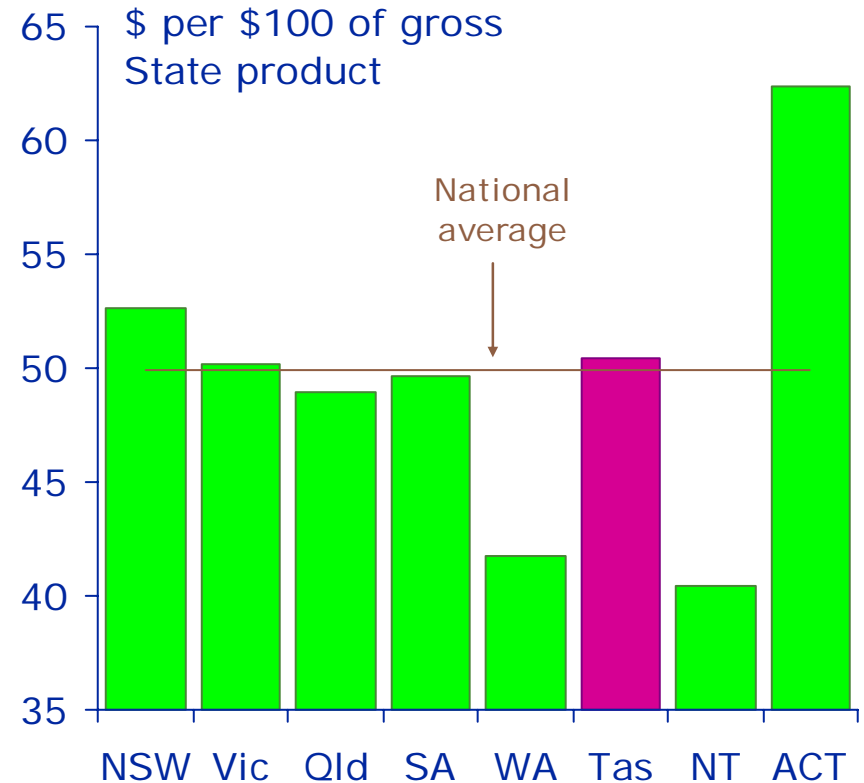
* Productivity defined as real gross State product per hour worked.
Sources: State Accounts (5220.0); ABS Employed persons by sex, age, hours worked, state (6291.0.55.001); Economics@ANZ.

Below-average productivity eliminates the 'advantage' of below-average labour costs

Labour cost per hour worked 2005-06



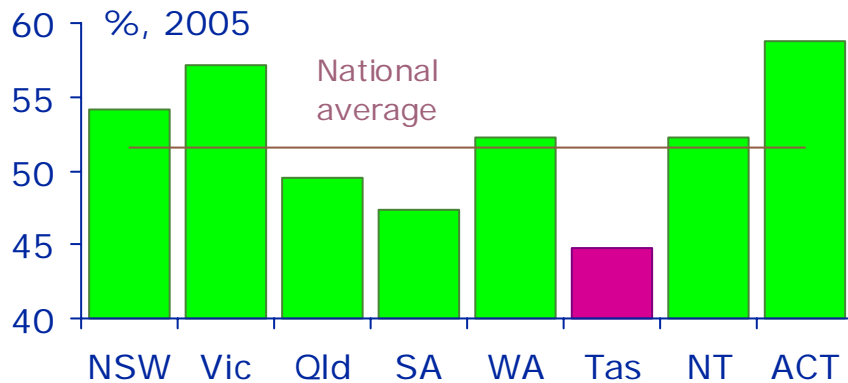
Labour cost per unit of output 2005-06



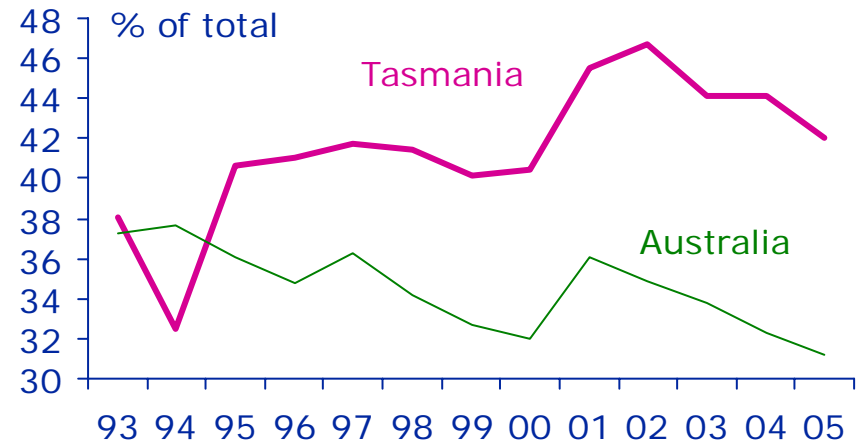
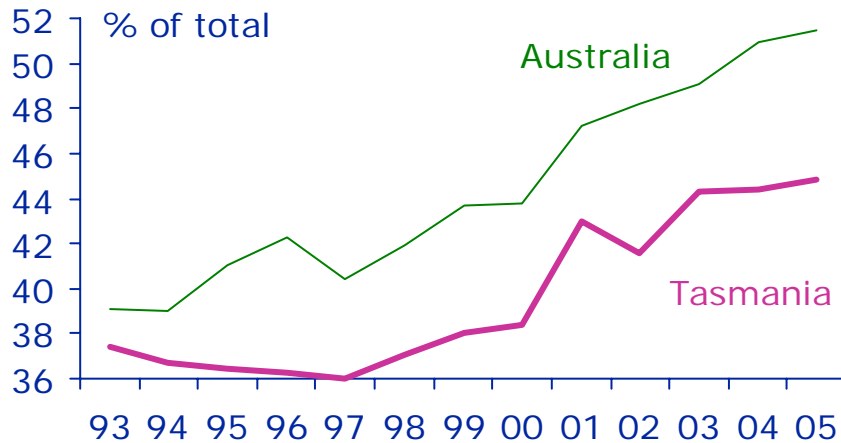
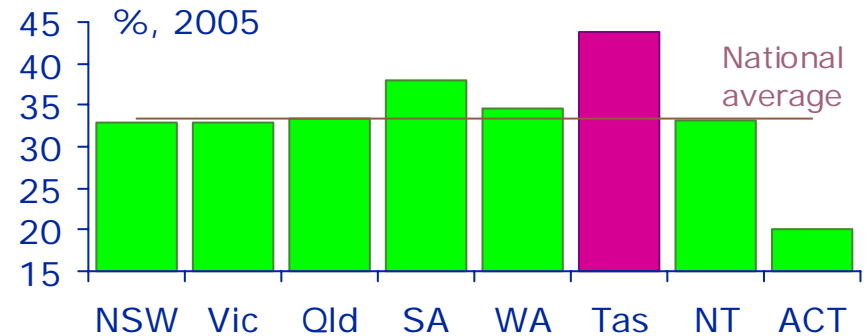
Sources: ABS State Accounts (5220.0); Employed persons by sex, age, hours worked, state (6291.0.55.001); Economics@ANZ.

Tasmania has the poorest educational attainment rankings of any State or Territory

15-64 year olds with post-school qualifications



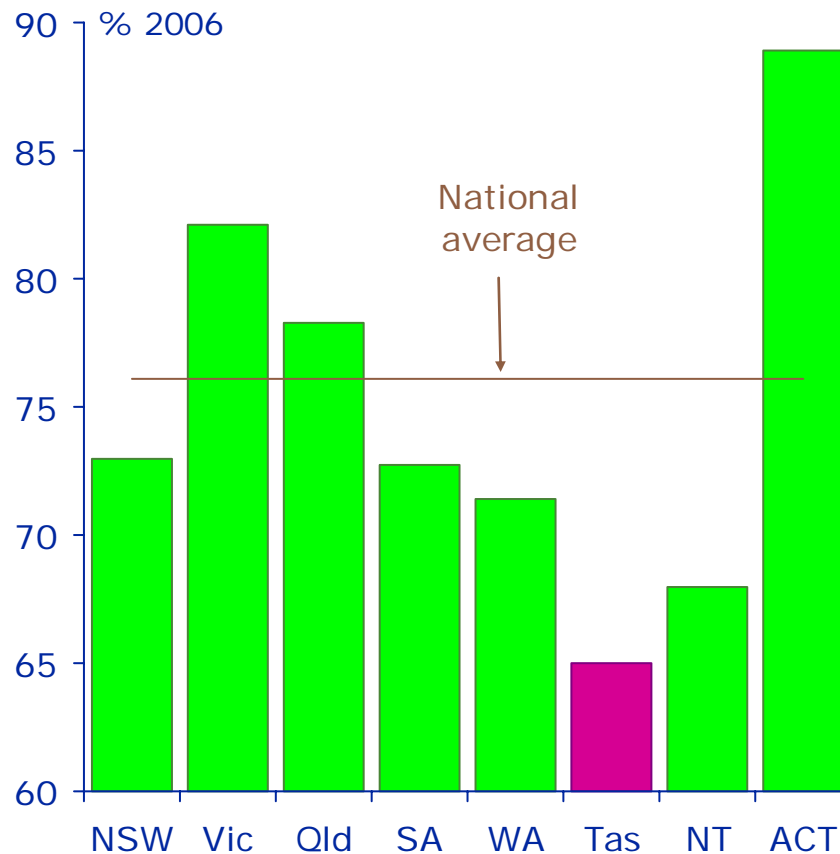
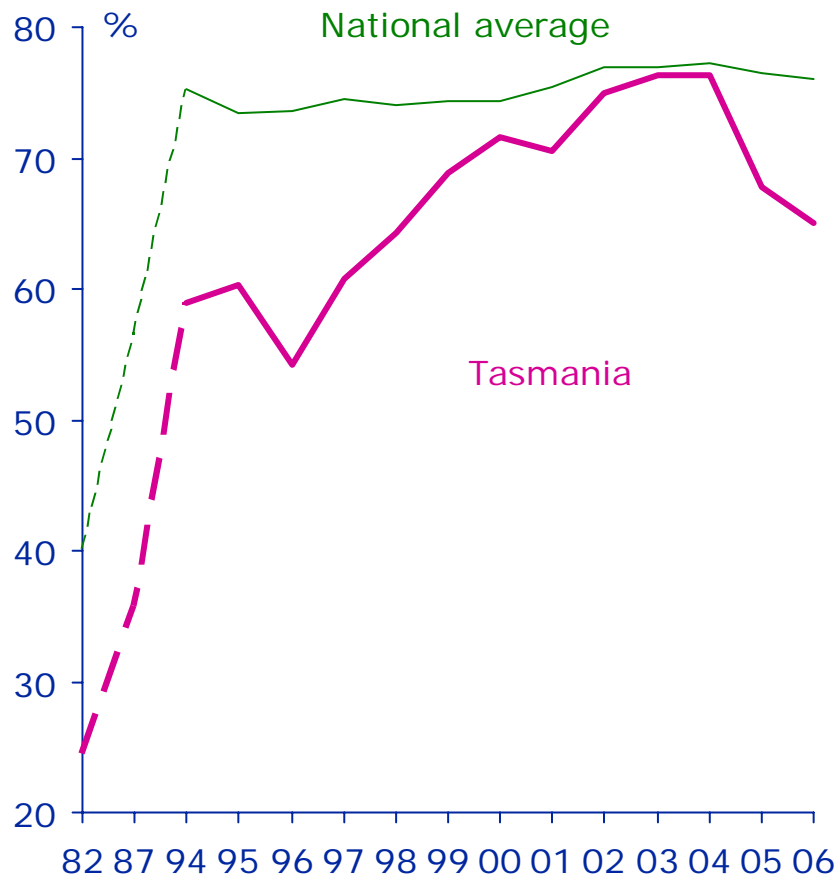
15-64 year olds who have not completed Year 12



Source: ABS, Education and Work, Australia, (6227.0); Australian Social Trends (4102.0).

Over the past three years the Year 12 retention rate has slipped back to its lowest since 1998

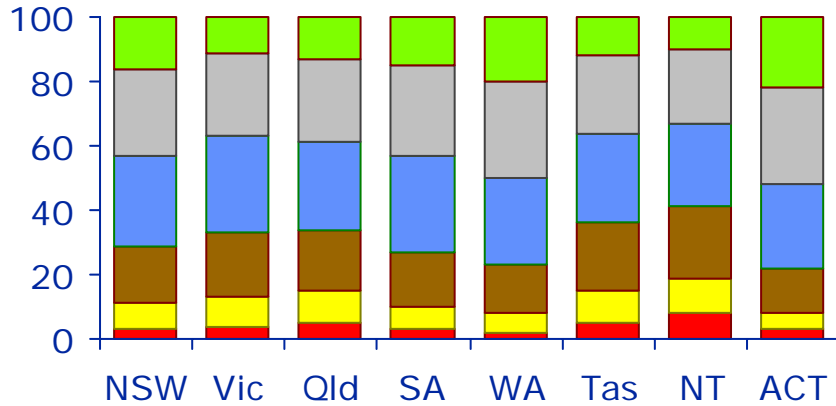
Apparent student retention rates from year 10 to year 12



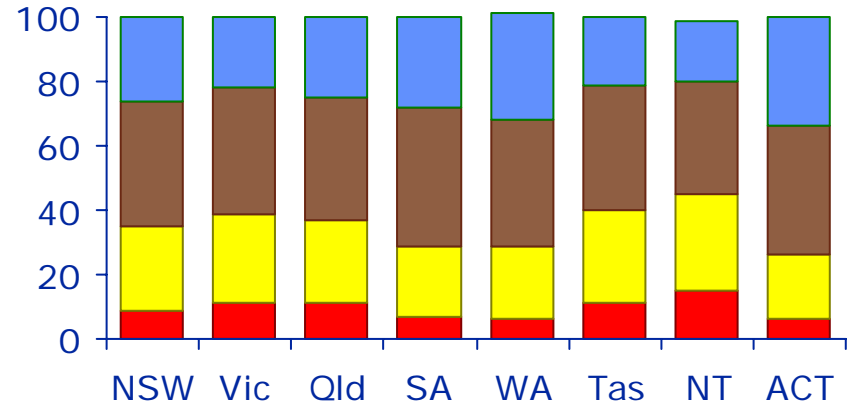
Source: ABS, Schools Australia (4221.0)

But it's also important to monitor quality of outcomes – where Tasmania isn't doing so well

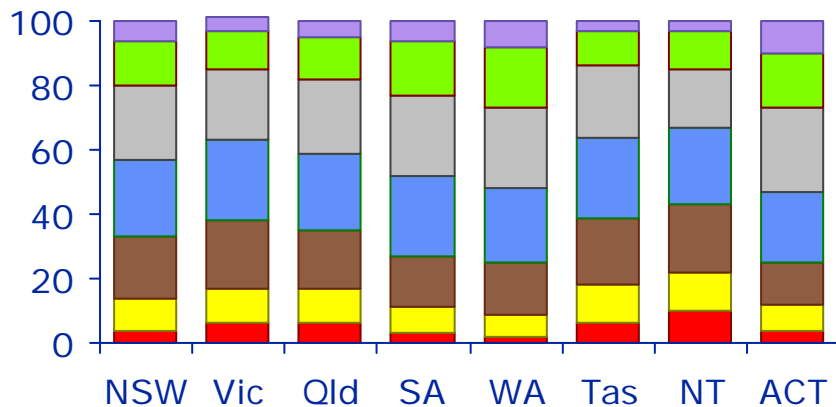
Reading literacy



Problem solving ability



Mathematical literacy



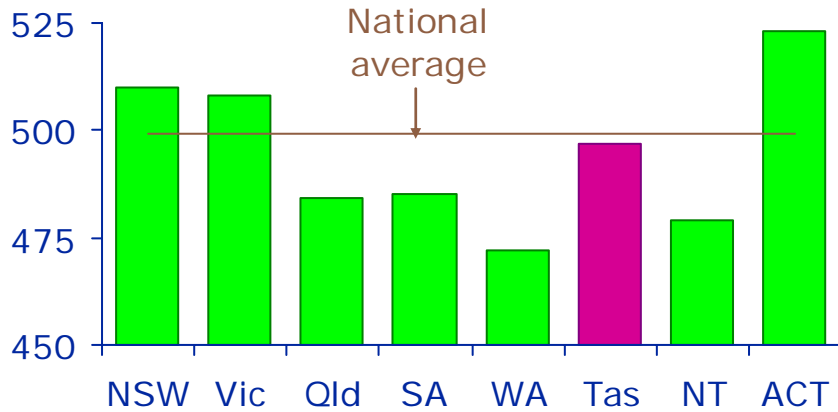
- Below Level 1 ('likely to be seriously disadvantaged in life beyond school')
- Level 1 (lowest) ■ Level 2 ■ Level 3
- Level 4 ■ Level 5 ■ Level 6 (highest)

Results based on testing of 12,500 students from 321 schools randomly selected from across Australia in 2003 as part of an OECD-sponsored assessment involving 41 countries.

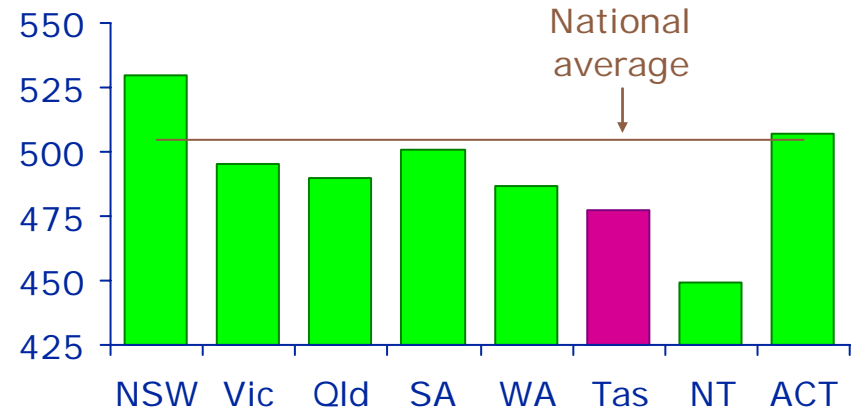
Source: Australian Council for Educational Research; Program for International Student Assessment (PISA).

Tasmanian students slip back relative to their mainland counterparts between Years 4 and 8

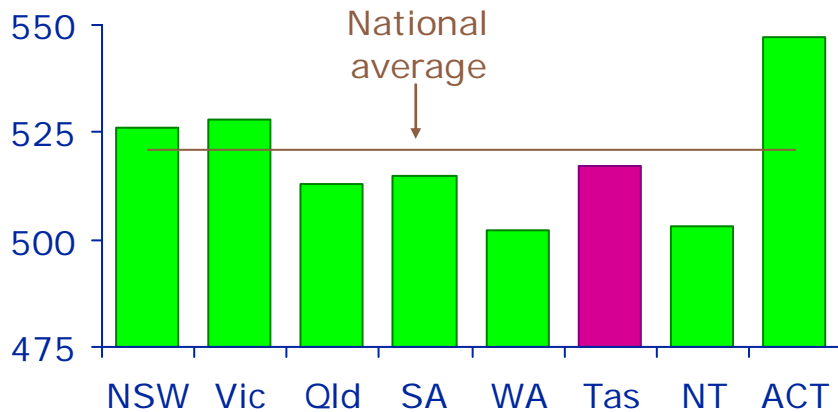
Average maths scores – Year 4



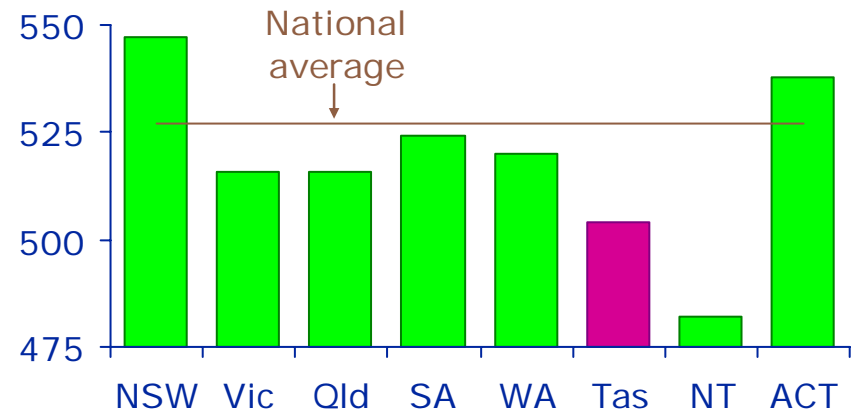
Average maths scores – Year 8



Average science scores – Year 4



Average science scores – Year 8



Source: Trends in International Mathematics and Science Study 2002-03

Treasurer Michael Aird's second Budget Speech said all the right things

- 'Increasing productivity is the cornerstone of economic growth. Without it, a return to a rust belt economy is a certainty'
 - Budget Speech, p 3
- 'Perhaps the greatest challenge that we face as a State to our ongoing productivity and economic performance is to improve education outcomes ...
For every year that we can add to the average level of educational attainment by young Tasmanians we will add 8% productivity to the Tasmanian economy'
 - Budget Speech, p 4
- 'Infrastructure drives our productivity. It provides long term security for our services. And it drives our prosperity'
 - Budget Speech, p 14

And the Budget Papers themselves have been greatly improved

- Detailed 'Policy and Parameters' Statement showing how policy decisions and changes in economic or other projections have influenced the shape of the Budget
 - Tasmania now provides better information on this score than the Commonwealth
- Full set of financial statements for the GBE sector and for the non-financial public sector as a whole for the full four years of the Forward Estimates period rather than just the coming financial year
 - again more information than provided by the Commonwealth or Victoria
- Forecasts or projections of key economic parameters for full four-year Forward Estimates period
 - together with an explanation of how Treasury's measure of 'State economic activity' is compiled
- Tasmania now second only to Western Australia in terms of quality of disclosure in Budget Papers

Yet the most striking thing about the 2007-08 Budget is its fiscal conservatism

Impact of 'policy decisions' and 'parameter variations' on the construction of the 2007-08 Budget

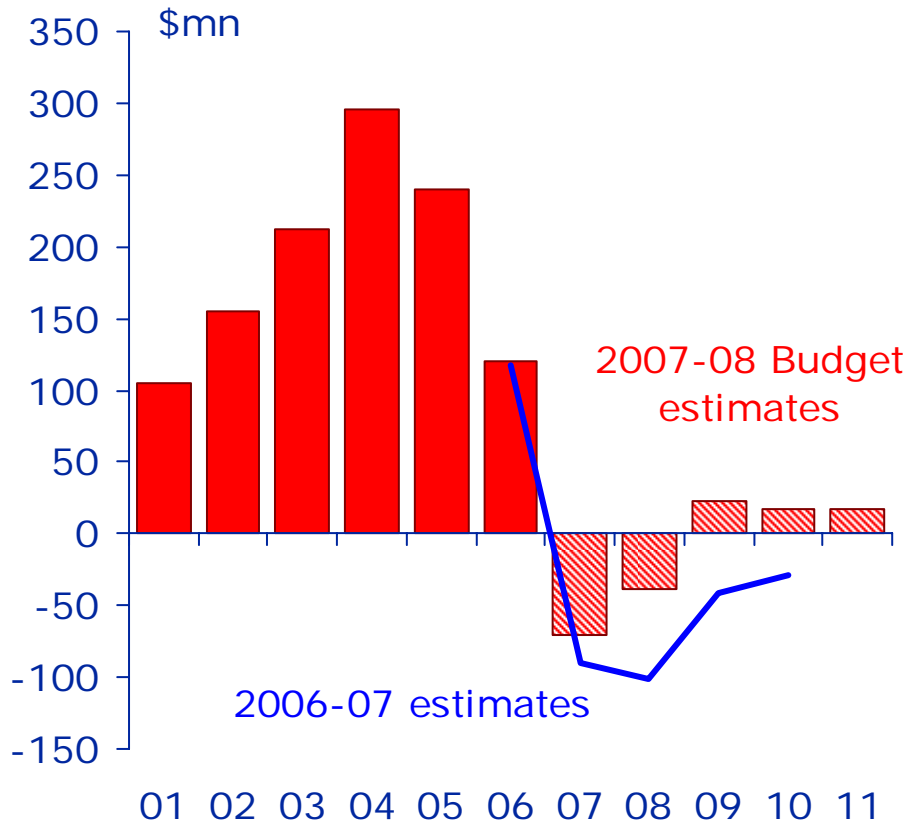
	<i>\$ millions</i>			
	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>Total</i>
<i>Net operating balance in 2006-07 Budget</i>	<i>-101</i>	<i>-43</i>	<i>-29</i>	<i>-173</i>
<i>Plus 'parameter variations'</i>				
Revenues	174	205	172	551
Expenses	-103	-146	-134	-383
<i>Total</i>	71	59	38	168
<i>Plus 'policy variations'</i>				
Revenues	7	8	7	22
Expenses	-17	-2	0	-19
<i>Total</i>	-10	6	7	3
<i>Net operating balance in 2007-08 Budget</i>	<i>-40</i>	<i>22</i>	<i>16</i>	<i>-2</i>

Note: A negative (positive) number in this table indicates that the variation detracts from (improves) the net operating balance.

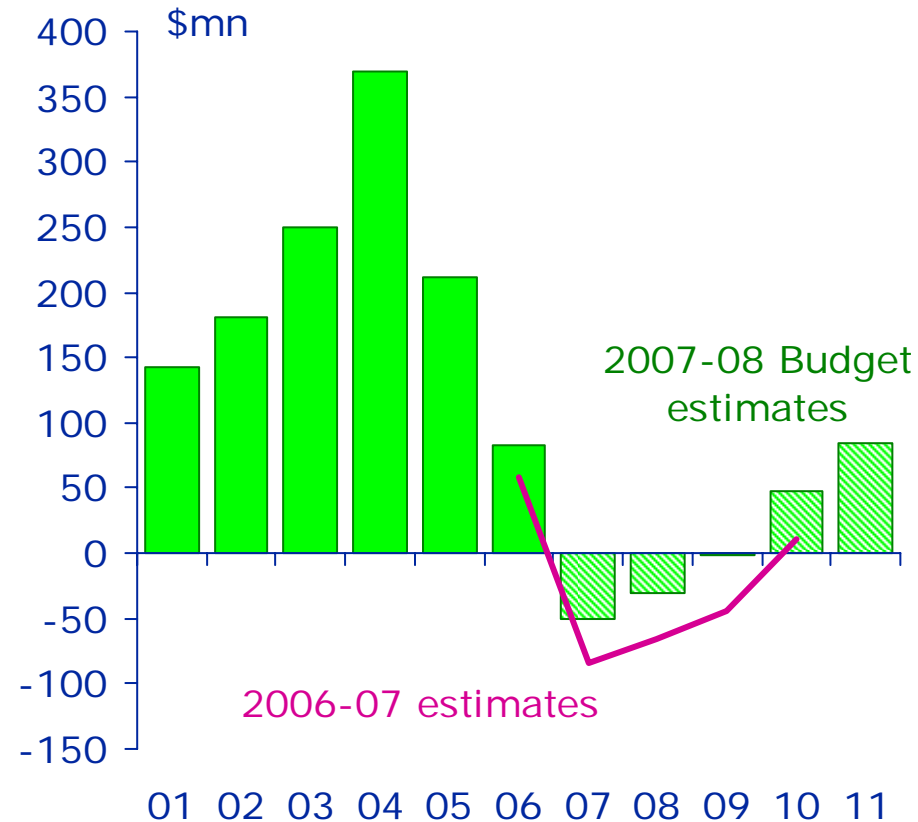
Sources: Budget Paper No. 1, Table 9.5

The main focus of the Budget was on attaining the fiscal strategy objectives outlined last year

Net operating balance



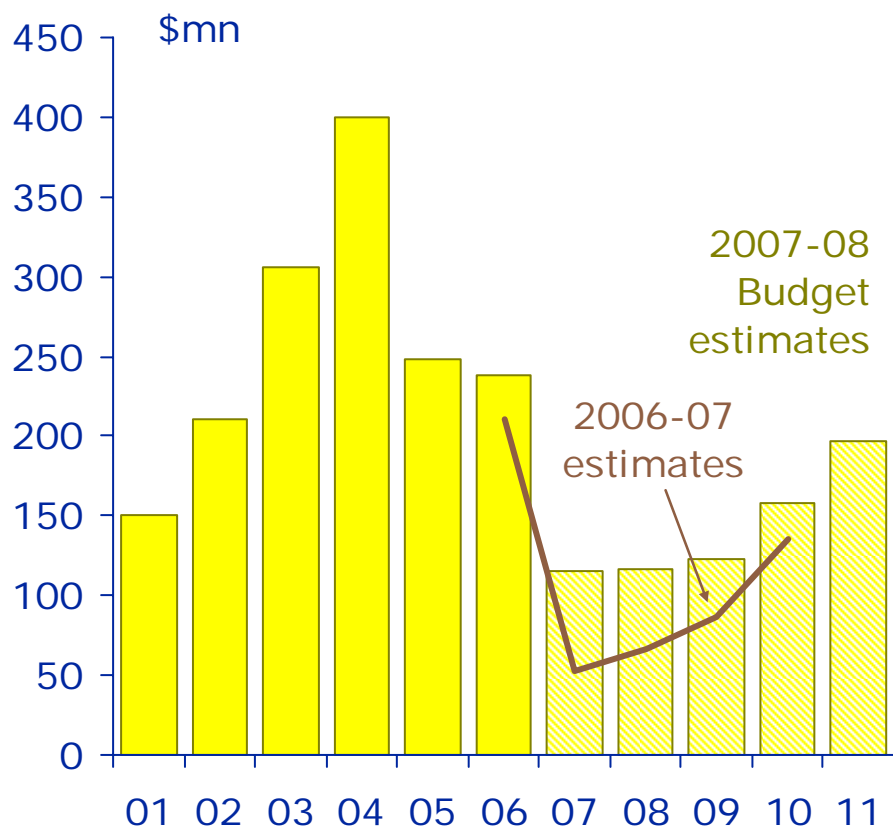
Fiscal balance



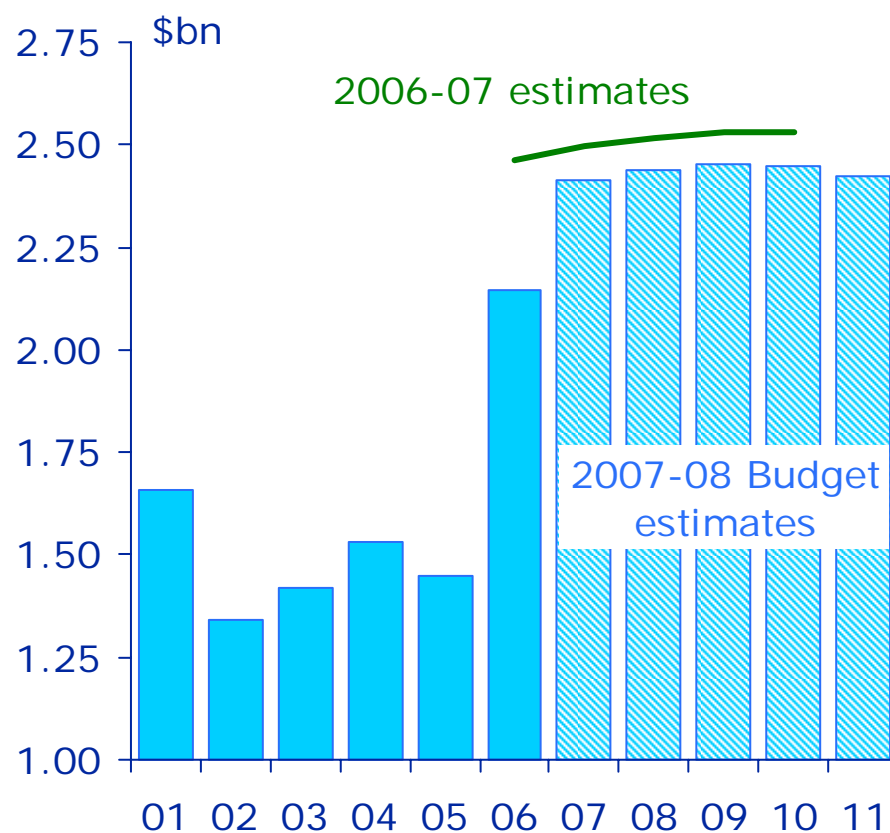
Sources: 2006-07 and 2007-08 Budget Paper No. 1, Table A1.1

Larger cash surpluses will be used to reduce the unfunded superannuation liability

Cash surplus



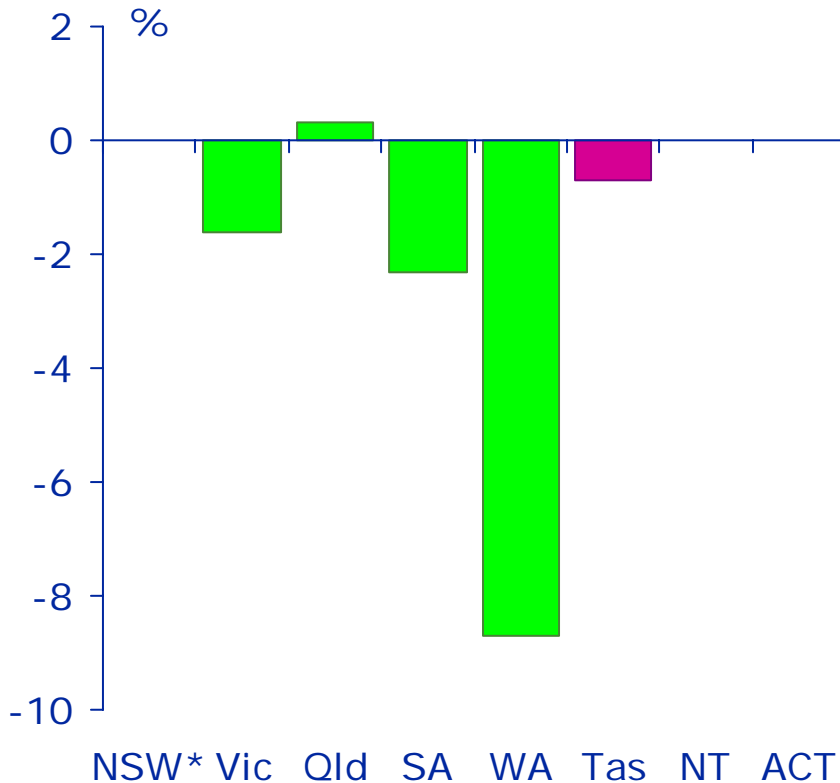
Net superannuation liability



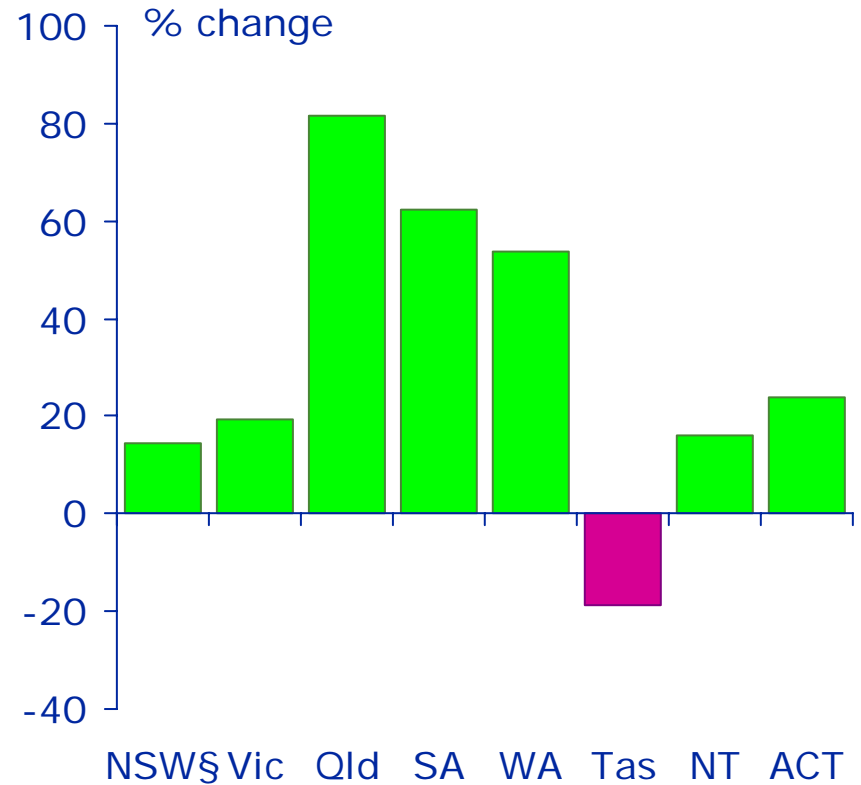
Sources: 2006-07 and 2007-08 Budget Paper No. 1, Tables A1.1 and 6.8

So Tasmania's 2007-08 Budget 'does' a lot less than other 2007-08 State Budgets

Average State tax reductions 2007-08 to 2010-11 as a pc of State tax revenues



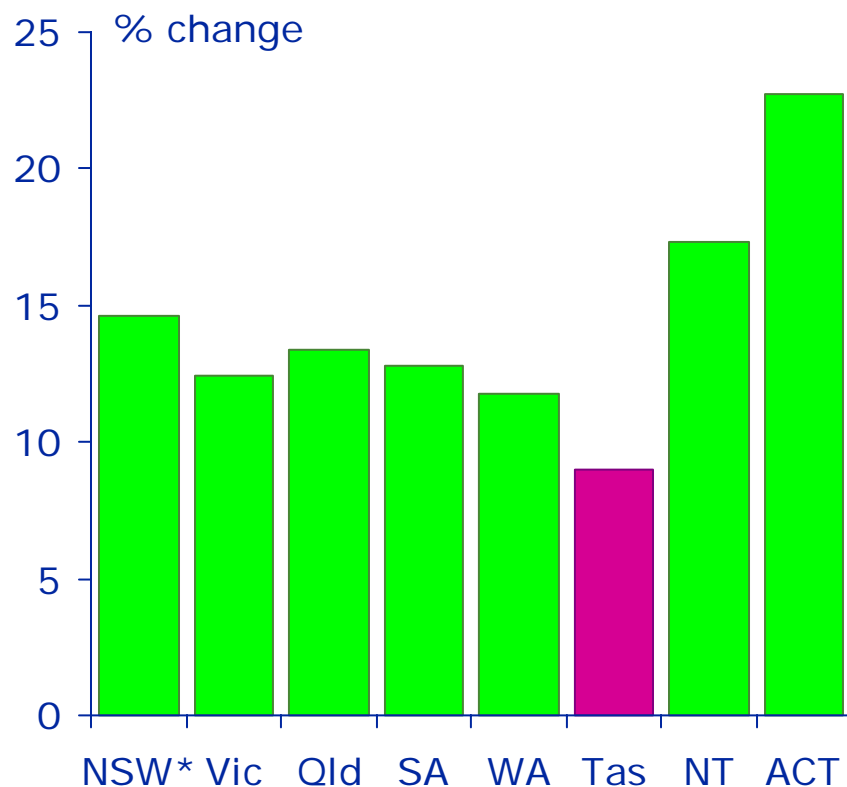
Average 'purchases of existing assets' 2007-08 to 2010-11 compared with 2005-06



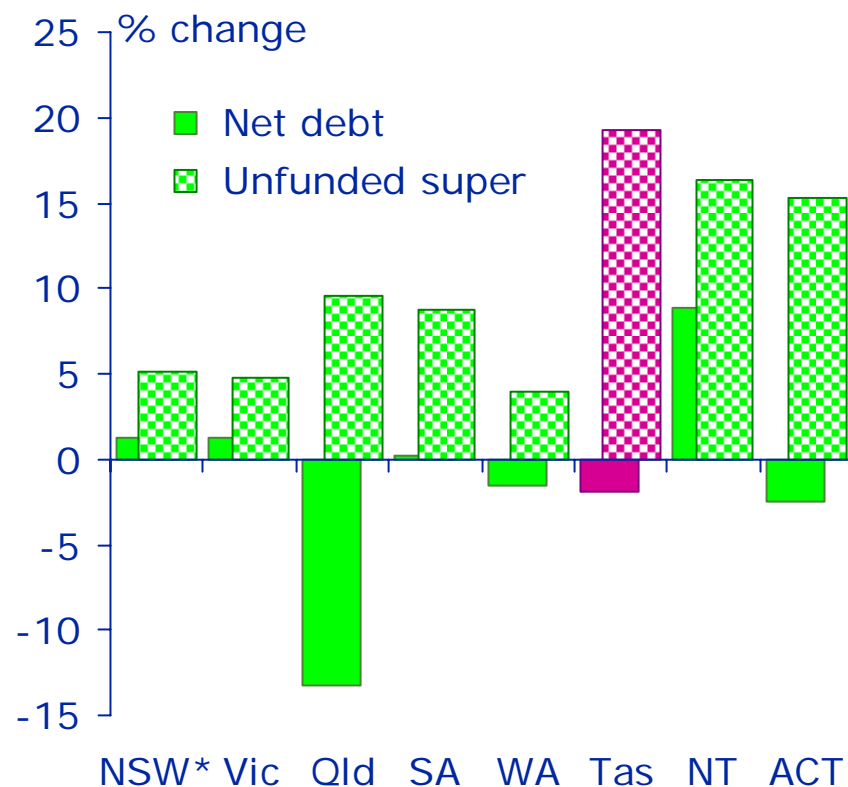
* Not available. § Based on 2006-07 Budget estimates.
Sources: State Budget Papers; Economics@ANZ calculations.

Tasmania's Budget flexibility constrained by poor revenue growth and unfunded super liabilities

Average 'general government' receipts 2007-08 to 2010-11 compared with 2005-06



General government net debt and unfunded superannuation liabilities, 30 June 2007



* 2007-08 to 2009-10.

Sources: State Budget Papers; Economics@ANZ calculations.

The Government needs to 'break out' of this fiscal straitjacket to meet key challenges

Decisions which need to be taken and funded

- New Royal Hobart Hospital – capital cost at least \$800mn
- Water, sewerage and irrigation reform – capital cost at least \$825mn
- Southern Transport Investment Program – at least \$280mn
- Likely recurrent expenditures associated with reform of the school education system and necessary increase in school retention rates

Options which need to be on the table

- Major asset sales – the Government has \$3.2bn of equity in GBEs and \$8.7bn of land and fixed assets
- Private sector involvement in infrastructure provision
- Direct user charging for infrastructure such as roads and water
- New borrowing – if the unfunded super problem can be solved
- Revenue measures

There's no reason why asset sales shouldn't be part of the financing mix for the new RHH

Key numbers for State-owned enterprises (\$ mn)

Business	Net assets as at 30 June 2006	Net profit after tax (2005-06)	Dividend and tax equivalent payments to State Budget (2005-06)	Plausible range of sale values based on p / e ratios of	
				13x	16x
Aurora Energy	333	22	32	291	358
Transend Networks*	529	31	44	397	488
Hydro Tasmania	907	44	67	576	708
MAIB§	173	58	82	760	935
Forestry Tasmania	569	10	19	134	165
TT Line	188	24	20	313	385
RWSC	12	-1	-2	-17	-21

Note: * excludes gifted assets. § 2004-05 results.

Sources: Annual Reports and Economics@ANZ calculations.

Budget forecasts of a pick-up in the Tasmanian economy seem plausible

- State Treasury forecasts 3½% growth in 'State economic activity' in 2007-08, up from 2½% (revised down from 2¾% in February's Mid-Year Review, 3½% in last year's Budget)
 - includes ½ pc pt contribution from assumed commencement of construction work on pulp mill in second half of the year
 - as well as Alinta Bell Bay power station and Musselroe Bay
- Employment forecast to grow by 2¼% in 2007-08, up from assumed ½% in 2006-07
 - 2006-07 employment growth more likely to be above ¾%
 - commencement of pulp mill construction expected to boost employment growth by ¼ pc pt, with some of those jobs going to interstate workers, lifting population growth by 0.1 pc pt to 0.7%
- Unemployment rate forecast to decline from average of 6% in 2006-07 to 5½% in 2007-08
 - 2006-07 unemployment now likely to average 5¾% so if employment grows as forecast, unemployment in 2007-08 could average 5¼% or lower

Summary

- The world economy is experiencing its longest period of above-trend growth in 3½ decades
 - sustained rapid growth in developing countries is boosting world growth, keeping inflation and interest rates low, and boosting demand for mineral and energy commodities
- Australia is one of the main beneficiaries of this pattern of global growth
 - boosting business and household incomes despite weak export growth, slowing productivity and the end of the housing boom
 - although the strong A\$ which is a by-product of the commodities boom hurts manufacturing, agriculture and tourism
- The 2007-08 Federal Budget continues the practice of re-distributing income from companies to households
 - which does boost domestic demand - and thus (with the economy at 'full employment') puts upward pressure on inflation and interest rates (though this won't show up until 2008) – even though the budget remains in surplus
- Tasmania's economy appears to be picking up after a sharp slowdown from mid-2005 through late 2006
- Tasmanian Government needs to consider bold options to break out of its fiscal straitjacket and address pressing economic and social needs